A4S ASSET OWNERS NETWORK

ENGAGING OUR ASSET MANAGERS TO SUPPORT OUR NET ZERO EMISSIONS COMMITMENT

Practical example: BT Pension Scheme

THE PRINCE OF WALES'S CHARITABLE FUND

BTPS

KEY HIGHLIGHTS

- The BT Pension Scheme (BTPS)'s approach to environmental, social and governance (ESG) revolves around the integration of ESG factors across our investment process and across all asset classes. The approach is integral to meeting BTPS's goal of net zero greenhouse gas (GHG) emissions across our portfolio by 2035.
- As we invest primarily through external asset managers, our interactions with them are crucial for enabling us to invest in a responsible way. We will select and retain asset managers that we believe can deliver the investment performance required and achieve our climate change targets.
- We will require our asset managers to report against a net zero climate scorecard which we will use annually to review managers' performance and, if necessary, manager changes will be made.

WHAT?

BTPS is the UK's largest corporate pension scheme, with net assets of over £57 billion. We are a defined benefit, closed scheme, with approximately 280,000 members. We pay around £2.5 billion in benefits a year.

In October 2020, we announced a commitment to achieve net zero GHG emissions across our entire portfolio by 2035. Overseen by the Board of Trustees, this goal will include five year targets, tracked and publicly rreported annually in line with the recommendations of the Task Force on Climate-related Financial Disclosures. Every three years a full reassessment of our progress, the progress of wider society and our goals will be undertaken. Our net zero goal now forms part of our wider responsible investment strategy.

Our manager selection and monitoring process has evolved over time, evaluating how managers integrate ESG factors into their processes in a way that's consistent with their investment strategy, as well as how they can evidence this. As part of our net zero commitment, we are redefining the mandate objectives we give to asset managers to include emissions-reduction goals consistent with our net zero 2035 commitment. This will include requiring them to report against a net zero climate scorecard, which we will assess during manager performance reviews, benchmarking against our expectations to ensure we remain aligned.

WHY?

We made our net zero GHG emissions by 2035 commitment because we recognize that emerging, long-term risks can have a materially adverse impact on the scheme. In meeting our long-term funding obligations, we believe climate change is one of the biggest risks posed to the scheme. At the same time, we believe there will be significant investment opportunities created by the low-carbon transition that the scheme can benefit from.

Investing in a responsible and climate sensitive way is also important to our members. We surveyed 8,500 of our members in early 2020, and found that 74% expect BTPS to consider the environmental and social impact of the investments we make, with 65% expecting us to use our investments to make a positive impact on the environment and society.

As the majority of BTPS's assets are managed by external asset managers (except for our government bond portfolio), the interaction we have with our managers is essential to us achieving our net zero 2035 goal and meeting the expectation of our members.

HOW?

Our approach to how we work with our asset managers aligns completely with the three pillars of our responsible investment strategy: long-term horizon; ESG integration and stewardship. We expect our asset managers to help us achieve our net zero 2035 goal, and our engagement with them reflects this expectation. For example:

- When appointing a new asset manager, ESG integration is a key factor we evaluate. We ask prospective managers to provide evidence of ESG integration in, for example, their fundamental analysis, asset valuation and portfolio construction. Importantly, it's always helpful to hear how ESG factors have influenced their investment decision making and why, both positively and negatively. It is critical for us therefore that the investment team has a strong understanding of ESG risks and opportunities and has ownership of the process.
- Our approach differs depending on whether the investments are passive or actively managed, and also the nature of the asset class. Our passive investments apply ESG filters that either favour higher ESG rated companies or screen out lower ESG rated companies. When we initially appoint active managers, we assess the candidates against the "ICE" criteria (integrated, consistent and evidenced):
  - How ESG is integrated into their investment strategy and approach.
  - If their ESG approach is consistent with their overall investment strategy.
  - How this work is evidenced in their investment papers and reporting.

- Once appointed, we require our managers to report annually against our net zero climate scorecard, appropriately tailored for each asset class. Examples of metrics on this scorecard include:
  - carbon footprinting;
  - forward looking climate metrics;
  - stewardship and advocacy activities;
  - internal climate change knowledge; and
  - exposure to transition investments, such as investments that provide low carbon solutions or help sequester carbon out of the atmosphere.

  We use the scorecard to review our asset managers' progress in helping us achieve our goals. If we don't believe sufficient progress is being made, we will look to implement appropriate changes, which may include moving to a new manager.

- We monitor each manager's ESG approach, challenging them around both underlying holdings and the portfolio level attributes through our ongoing discussions and, more formally, at our quarterly review meeting. We have made investment decisions based on climate considerations. For example, 2-3 years ago we exited from a passive value equity strategy which gradually became exposed to companies with high emissions and generally poor ESG criteria. Following extensive analysis, which assessed the ways the portfolio could be evolved, we reallocated the capital to a few of our active equity managers. This had a very positive impact on the listed equity portfolio's overall ESG scores and carbon metrics as well as our ability, through the managers, to support companies with commitments to decarbonize.
- We also drive much of our stewardship activity through our asset managers and Hermes EOS. We provide strategic direction to Hermes EOS, input into setting objectives and establishing priority themes and issues within a three year engagement plan. We actively monitor and review their activities through quarterly calls and regular reports. We disclose highlights of our engagement activities across equity, credit, property and infrastructure investments within our annual report, disclosing information such as equity voting and providing case studies on engagement activity.

NEXT STEPS

We will continue to align our key investment mandates with our net zero emissions 2035 goal and will continue to do so throughout the rest of the year. We recognize this as a journey that we are sharing with our asset managers and we will continue to engage with them – through set processes and through regular communication – to ensure that our investments continue to meet the needs of our net zero emissions 2035 goal and ultimately our beneficiaries.

"Climate change poses a clear and present threat to the scheme's ability to meet its long-term commitments. Continued increases in global warming will amplify existing risks and create new risks with potentially irreversible and catastrophic impacts on markets, society and the environment. Setting a net zero goal of 2035 is ambitious but we believe the time to act is now and we hope that others will join us in setting their own net zero goals."

OTTO THORESEN,
CHAIR OF THE BT PENSION SCHEME

TOP TIPS

MAKE TIME FOR TRUSTEE 'TRAINING'

Help trustees understand what they should expect of their asset managers on ESG by highlighting material topics and including third party expert knowledge on how asset managers can respond to these topics.

DO NOT BE AFRAID TO CHALLENGE YOUR ASSET MANAGERS

ESG is no longer a new concept for asset managers, and as fiduciaries, they are responsible for considering ESG factors when making investment decisions, so you are well within your rights to question their activities. Regular conversations to encourage continuous improvement and being honest when performance needs to improve are key.

Ask lots of questions at meetings; requesting the ESG analyst doesn't attend along with your fund manager, will highlight how much the ESG considerations are felt throughout, not just by their ESG team.

ENGAGE ON STEWARDSHIP

Engage your asset managers on your stewardship approach, including voting objectives and priority themes and issues. Key questions to ask your asset manager could include:

- Why is this topic material to an investment?
- What came about as a result of your engagement or vote?
- How are you following it up, what are the next milestones?
- What's your end goal with this engagement?

ASK YOUR ASSET MANAGERS TO BRING THE DATA TO LIFE

Request the portfolio level data and ask the manager to take you through it, eg which companies are driving the scores and why? How do these scores reconcile with your asset manager's internal ratings / views?

Ask them to provide examples of investments that a) have been rejected because of ESG considerations; b) have been implemented despite ESG risks; or c) they have divested from because of change/ lack of change to specific ESG factors.

GET IN TOUCH OR FIND OUT MORE

@PrincesA4S

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A4S ASSET OWNERS NETWORK

The A4S Asset Owners Network is a grouping of pension fund chairs and trustees to discuss integrating sustainability into investment decision making. Click here to find out more.